

COMMONWEALTH OF MASSACHUSETTS

SUFFOLK, SS.

SUPREME JUDICIAL COURT
FOR SUFFOLK COUNTY
NO. SJ-2000-0475

LINDA L. RUTHARDT, as she is)
COMMISSIONER OF INSURANCE of the)
COMMONWEALTH OF MASSACHUSETTS,)
)
Plaintiff,)
)
v.)
)
LUMBER MUTUAL INSURANCE COMPANY,)
SEACO INSURANCE COMPANY, and)
NORTH AMERICAN LUMBER INSURANCE)
COMPANY.)
Defendants.)

RECEIVER'S FIRST STATUS REPORT

In accordance with paragraph 9 of the Injunction and Order Appointing Receiver entered November 1, 2000 (the "Receivership Order"), I, Linda L. Ruthardt, Commissioner of Insurance, as Receiver (the "Receiver") of Lumber Mutual Insurance Company, SEACO Insurance Company and North American Lumber Insurance Company (collectively, "Lumber"), hereby submit this status report, summarizing the steps taken to date in the rehabilitation of Lumber and outlining my plan for the payment of its obligations in full.

1. Initial administrative steps. Upon entry of the Receivership Order, I immediately took possession of the property and assets of Lumber. In order to provide on-site assistance, I engaged the services of American Patriot Group Inc. ("APG")¹ and Associated Insurance Management Inc. ("AIM, Inc."). Their services are being charged to Lumber on the basis of their actual cost (in the case of APG) or cost plus 10% (in the case of AIM, Inc.). APG and AIM, Inc. will be indemnified by Lumber except with respect to their gross negligence or willful misconduct.

2. Notice of appointment and coordination with insurance regulators. Written notice of my appointment as Receiver was provided to all policyholders of Lumber in the form approved by the Court. I utilized the facilities of the National Association of Insurance Commissioners ("NAIC") to alert all other chief insurance regulators of the Lumber proceeding. In addition, my staff and counsel provided a briefing on the status of this proceeding to the NAIC Financial Analysis Working Group at its meeting in Boston last month. My representatives have also worked closely with officials of the Minnesota Insurance Department, the chief regulator of Forest Products Insurance Exchange ("Forest Products"), a Minnesota reciprocal insurer for which Lumber's affiliate, Forest Products Managers, Inc., acts as attorney-in-fact.

¹ APG is a wholly owned subsidiary of the American Mutual Liability Insurance Company, in Liquidation ("AMLICO"). By virtue of my appointment as Permanent Receiver of AMLICO, I also control the operations of APG.

3. Lumber's policies cancelled by January 1, 2001.

Lumber ceased writing new business upon the entry of the Receivership Order. Pursuant to that Order, all outstanding policies of insurance issued by Lumber were canceled effective as of 12:01 a.m. on January 1, 2001. The Receivership Order also provided for the cancellation of a reinsurance agreement between Lumber and Forest Products. For that reason, all outstanding policies of insurance issued by Forest Products were also canceled effective as of 12:01 a.m. on January 1, 2001.

4. Lumber's obligations continue to be paid in the ordinary course. All payments to Lumber's policyholders and to its other creditors are continuing to be made in the normal course, in accordance with the Receivership Order. As of November 30, 2000 there were pending claims relating to approximately 5,700 incidents under Lumber's policies of insurance. A significant percentage of the pending claims are workers' compensation claims, a number of which may logically be expected to remain open for a substantial period of time.

5. Employee retention program implemented. As of the commencement of this proceeding, Lumber's operations were staffed by 236 employees, located in its Framingham, Massachusetts corporate headquarters and regional offices in California and South Carolina. In order to induce the continued employment of Lumber's employees during this difficult period, I implemented a Job Retention Program on November 30, 2000. Under this Program, from December 1, 2000 through December 31, 2001, retention pay will accrue for all eligible employees at the rate

of 2% of salary rates per month. In order to be eligible for retention pay, the employee must remain employed until his or her position is eliminated (and must not be removed for cause). Payments under the Job Retention Program will begin later in 2001, and will be staggered thereafter.

6. Extensive efforts made to identify buyers or merger partners. As outlined in the Verified Complaint, one of my objectives in the rehabilitation of Lumber was to explore the feasibility of transaction(s) for the affiliation or sale of Lumber or its material business assets. To that end, my representatives contacted approximately twenty other insurers that had been identified as potentially interested, and invited them to enter into confidentiality agreements to facilitate consideration of such a transaction. In addition, other interested persons have been in contact with my representatives. To date, this process has resulted in the consummation of transactions (described below) with two insurance agencies by which the Lumber book of business is now being re-written.

7. Agreement entered to sell rights of renewal for eastern U.S. business. On December 4, 2000, an agreement was executed with Allied American Insurance Agency, Inc. ("Allied"), a large Massachusetts insurance agency, by which Allied acquired the rights of renewal for the business written by Lumber Mutual Insurance Company and North American Lumber Insurance Company in the six New England states, New York, New Jersey, North Carolina, South Carolina, Georgia and Tennessee (and certain accounts in Maryland, Pennsylvania and Virginia). A copy of the

agreement is attached hereto as Exhibit "A". Under its terms, Allied will share with Lumber a percentage of the commissions which it earns by re-writing the subject business for a five year period. The percentage payable to Lumber varies from 10% in the first year, 15% in the succeeding three years, and 5% in the fifth year. In addition, Allied will pay to Lumber the same percentages of any management fees which it derives from the administration of a New York workers' compensation safety group previously administered by a Lumber affiliate. In conjunction with the agreement, Allied has hired thirteen Lumber sales representatives, and is interviewing members of Lumber's support staff for other open positions.

8. Agreement entered to sell rights of renewal for California business. On December 8, 2000, an agreement was executed with Bowermaster & Associates Insurance Agency, Inc. ("Bowermaster"), a California insurance agency, by which Bowermaster acquired the rights of renewal for the business written by Lumber Mutual Insurance Company in California. A copy of the agreement is attached hereto as Exhibit "B". Under its terms, Bowermaster will share with Lumber a percentage of the commissions which it earns by re-writing the subject business through December, 2004. The percentage payable to Lumber varies from 15% to 30%, depending upon the total amount of commissions so earned by Bowermaster. In conjunction with the agreement, Bowermaster is considering hiring three Lumber sales representatives.

9. A 2001 Lumber run-off plan has been developed. A run-off Business Plan for 2001 has been developed with the assistance of Lumber's staff and my representatives, a copy of which is attached as Exhibit "C" ("the Plan"). I believe that the Plan's underlying assumptions reasonably reflect Lumber's current status in run-off. The primary variables which will impact upon the successful achievement of the Plan's projected financial results include the ultimate cost of claims, our ability to successfully manage operations at the expense level projected, and the actual collection of the earned premium contemplated by the Plan. The Plan provides for staffing reductions throughout 2001, commencing with the elimination of 103 positions during the month of January, 2001 (most significantly in outside sales, loss control, marketing and underwriting functions). In addition, the Plan calls for the closing of Lumber's two regional offices by March 23, 2001.

10. Although impaired, Lumber appears solvent. The Plan projects Lumber's surplus (net worth) at December 31, 2000 to be approximately \$10,900,000. Surplus is projected to further decrease to approximately \$9,151,000 by December 31, 2001. Based upon these projections, and the reasonableness of the Plan's underlying assumptions, I have concluded that Lumber, although very thinly capitalized, is solvent. I therefore believe that it is appropriate for Lumber to continue to meet all of its obligations in the normal course. Throughout 2001, actual operating results will be compared to the Plan on a quarterly basis. If Lumber's 2001 operating results vary

materially from the Plan, I will of course revisit these preliminary conclusions.

11. Loss portfolio reinsurance transactions are under consideration. Lumber has received proposals from two different reinsurers for loss portfolio transfers. Under such proposed arrangements, Lumber has the opportunity to transfer a portion of the risk of adverse development of outstanding losses under its policies to these reinsurers. The proposals also include run-off management services available from the reinsurers or their affiliates. My consulting actuaries at the firm of Tillinghast are presently reviewing these proposals. In the event that I decide to enter into a loss portfolio transfer, I will first submit the proposed agreement to the Court for its approval.

12. Agreement reached to sell Lumber's home office property. Lumber owns and presently occupies part of a 65,974 square foot office building in Framingham, Massachusetts as its corporate headquarters facility. A term sheet has been executed for the sale of the property to Carruth Capital, LLC, and for a leaseback of the third floor of the facility to Lumber for up to three years. A copy of the term sheet is attached hereto as Exhibit "D". I anticipate filing a motion for approval of the sale with the Court shortly. In the event that the sale is consummated on the proposed terms, Lumber will net approximately \$6,000,000 in excess of the value for which the property was carried on its September 30, 2000 quarterly financial statement.

13. I plan to file my next report with the Court after the completion of Lumber's December 31, 2000 financial statements, which I expect will occur in March. I will utilize the services of Tillinghast to evaluate the adequacy of Lumber's 2000 loss reserves and Ernst and Young to audit the December 31, 2000 financial statements.

Respectfully submitted,

Linda L. Ruthardt
Receiver

Dated: January __, 2001

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